

**REDACTED COPY**

STATE OF MAINE  
PUBLIC UTILITIES COMMISSION

Docket No. 99-901

August 1, 2001

OFFICE OF THE PUBLIC ADVOCATE,  
Petition to Investigate Revenues and  
Rates of Northern Utilities, Inc.

ORDER

WELCH Chairman, NUGENT & DIAMOND Commissioners

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**I. SUMMARY**

On December 14, 1999, the Office of the Public Advocate (OPA) filed a request that the Commission initiate an investigation to determine whether the rates of Northern Utilities, Inc. (Northern or NU) are just and reasonable.<sup>1</sup> We have considered evidence presented by the OPA and by NU and determine that it does not provide a sufficient basis for initiating a formal investigation of the Company's rates at the present time.

**II. PROCEDURAL HISTORY**

In its filing, the OPA asserted that Northern may be over-earning and, in support of its view, filed a preliminary rate of return analysis performed by consultant Stephen G. Hill of Hill Associates. By letter dated December 23, 1999, Northern requested that the Commission allow Northern an adequate opportunity to review and respond to the OPA's filing before taking any action on the request.

The Commission issued a Notice of Summary Investigation and Procedural Order on December 30, 1999 noting that the OPA's request and the related analysis focused principally upon rate of return and related issues without directly addressing the question of whether Northern's current rates were likely to produce a reasonable earned rate of return. The Notice indicated that we required further information regarding Northern's actual earnings in order to determine whether Northern's current rates continue to be reasonable. Consequently, the Commission indicated it would conduct a preliminary review of this matter as a summary investigation under 35-A M.R.S.A. §1303(1) and would begin a formal investigation only if the summary investigation produced evidence that sufficient grounds exist to warrant one. A copy of the Notice was sent to the service list in Docket No. 97-393. The Commission also directed Northern to file a response to the OPA's petition by January 14, 2000, including an analysis showing its actual earnings for its Maine Division in a recent 12-month period and, to the extent feasible, projected earnings for the Maine Division for a reasonable future 12-month period.

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<sup>1</sup> On December 17, 1999, the OPA made a corrected filing of its petition.

On January 13, 2000, Northern filed a request for a protective order limiting distribution of certain information to the Office of the Public Advocate, the Commission and Advisory Staff. On January 14, 2000, the Hearing Examiner issued an Order on Motion for Protective Order and Temporary Protective Order to establish confidential treatment for information produced by Northern relating to or discussing actual and forecasted revenues, earnings and underlying financial data. Northern provided this information on January 14, 2000 and later supplied redacted versions.

The Hearing Examiner further directed Northern to file a precise identification of and full justification for those portions of its submitted material that required protection. The Company did so on February 18, 2000. Subsequently, Staff held a telephone conference of the parties on January 20, 2000. On February 14, 2000, Northern provided schedules and work papers in support of its earnings analysis.

On February 8, 2000, Maritimes & Northeast Pipeline, LLC, filed a petition to intervene.

### III. ANALYSIS AND DECISION

#### A. OPA Filing

The underlying premise of the OPA's request for a formal rate investigation is that, through approval of a stipulation in *Northern Utilities, Inc., Proposed Increase in Rates*, Docket No. 83-218, NU was allowed a weighted average cost of capital (WACC) of 12.26% (no ROE was specified in the stipulation) and that market conditions indicate that lower WACC and ROE<sup>2</sup> numbers are appropriate in the current environment.

In the most recent rate cases filed at the Commission (the electric "mega-cases") where ROE was at issue, filings made by various witnesses and the Bench included specific data related to natural gas local distribution utilities (LDCs) that indicated that the cost of equity for natural gas LDCs *could have fallen* to levels below 11.00%. The OPA's consultant, Mr. Stephen G. Hill, indicated that an appropriate WACC for NU was 9.01% with a corresponding ROE of 10.50%. While Northern's base rates have not changed, OPA points out that approved costs flowing through the Cost of Gas Factor and Environmental Response Cost Adjustment have combined to raise rates to residential customers by a cumulative 17% in recent years, including such items as costs for environmental remediation, costs associated with a cancelled liquefied natural gas storage facility in Wells, Maine, increased capacity costs on the Portland Natural Gas Transmission System (PNGTS) pipeline and a rate redesign case. See *Northern Utilities, Inc., Proposed Environmental Response Cost Recovery*, Docket No. 96-678, Order Approving Stipulation (Apr. 28, 1997); *Northern Utilities, Inc.*,

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<sup>2</sup> In this Order we use the terms Return on Equity, Cost of Equity and ROE interchangeably.

*Investigation of Decision to Terminate Agreement with Affiliate, Granite State Gas Transmission Company, for LNG Services*, Docket No. 99-259, Order (Dec. 3, 1999); *Northern Utilities, Inc., Proposed Precedent Agreement with Portland Natural Gas Transmission System for Transportation Service*, Docket No. 96-558, Order (Dec. 19, 1996) and *Northern Utilities, Inc., Firm Transportation Agreements with Portland Natural Gas Transmission System*, Docket No. 98-093, Order (Mar. 30, 1998); and *Northern Utilities, Inc., Request for Approval of Rate Design and Partial Unbundling Proposal*, Docket No. 97-393, Part One Order Approving Stipulation (Sept. 3, 1999).

Mr. Hill's preliminary analysis appears to be within the range of reasonable outcomes for the time in which it was done.<sup>3</sup> In addition, the OPA's assertions regarding the approved cost items noted above, which the OPA refers to as "various single-issue proceedings" (petition page 3, paragraph 8), appear to be correct. However, the OPA's filing stopped short of providing an analysis of the financial statements of the Maine Division of NU to support its claim that Northern is now over-earning. There was no calculation of either the recent net income earned by NU's Maine Division or actual common equity balance against which net income would be measured to determine the Maine Division's earned ROE.

B. NU's Responsive Filing

The Company's January 14, 2000 filing disputed Mr. Hill's ROE recommendation and also provided a summary analysis of its actual Maine Division earnings. This filing noted several reasons why Mr. Hill's analysis understated the total risk of NU in today's environment and why he thus recommended an inadequate ROE and WACC. Finally, the Company noted that its last allowed WACC was actually 9.93% in *Northern Utilities, Inc., Staff's Proposed Revenue Adjustment filed Pursuant to Chapter 90 of the Commission's Rules*, Docket No. 87-164, rather than the 12.26% cited by Mr. Hill in the 1983 case.

Northern provided additional information in a January 20<sup>th</sup> filing, including summary income statements, earned ROEs and rate base data for a 12-month "test year" ended September 30, 1999 and for a forecasted "rate year" ending December 31, 2000. After resolving confidentiality issues surrounding the work papers supporting the schedules filed on January 20, NU filed those on February 17, 2000. NU's calculations indicated that the Company earned a WACC and ROE of **[begin confidential]**

**[end confidential]** respectively based on the September 30, 1999 "test year" and **[begin confidential]** **[end confidential]** respectively based on the forecasted calendar December 31, 2000 "rate year." These numbers are less than **[begin confidential]** **[end confidential]** the 9.93% WACC allowed in Docket No. 87-164.

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<sup>3</sup> If we were electing to pursue this matter today, some 17 months later, we would have requested that Mr. Hill update his analysis.

C. Commission Decision

Based on the record before us in this Docket, we decline to Order a full investigation of Northern's rates in this docket. While the possibility exists that capital costs are lower today than at the time of the Company's last revenue adjustment in 1987, the Company's calculation of its recent earnings based on a September 30, 1999 "test year" and its projected December 31, 2000 "rate year" earnings do not suggest that NU is over-earning at its current rate levels.

We have reached this conclusion by uncritically accepting as reasonable the level of inter-company "service" or "management" fees paid by NU to its parent company(ies), as shown in its January 14 and February 17, 2000 filings. We note that the information provided by the Company did not allow Advisory Staff to carefully scrutinize the inter-company "management fees" that appear in the O&M Expense line of NU's income statement. Management services are provided by NU's parent companies and affiliates, Bay State Gas Company and NiSource (formerly known as NIPSCO), under contracts approved by the Commission.<sup>4</sup> This is an important point, as these "management fees" total **[begin confidential]**

. **[end**

**confidential]**. The possibility exists that a line-by-line review of these fees would result in a disallowance of some portion of them, which would thus raise NU's earned ROE by some amount. It is unclear whether that amount of management service fees alone would be enough to convince us to open a general rate investigation.

Given that it has been many years since NU's last full rate proceeding and that unreviewed inter-company management fees are a significant portion of the Company's non-gas expenses, it is quite likely that it will make sense to open an investigation of Northern's rates in the not too distant future. However, at this time, based on this record, it does not make sense to proceed. Since the last Northern rate case there have been two major reorganizations involving NU's parent company. In early 1998, Bay State Gas agreed to be acquired by NIPSCO industries (NIPSCO) of Indiana. See *Northern Utilities, Inc., Request for Approval of Reorganization, Merger with NIPSCO Industries*, Docket No. 98-216. In 2000, NiSource, Inc., (formerly NIPSCO) agreed to acquire the Columbia Energy Group (Columbia) of Virginia. See *Northern Utilities, Inc., Request for Approval of Reorganization, Merger and Related Transactions*, Docket No. 2000-322.

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<sup>4</sup> We note, however, that Northern has not filed updated management service agreements since its merger with NIPSCO (later renamed NiSource) in 1998 or since the merger of NiSource with Columbia in 2000, despite changing service arrangements within the Company. Section 707 prohibits a public utility from entering affiliated contracts without Commission approval and, if a public utility engages in prohibited arrangements, permits disallowance for ratemaking purposes of amounts of payments that the Commission finds not to be in the public interest.

Both transactions promised significant operating expense savings at the corporate level, some of which would eventually be flowed to individual operating companies such as NU. The Bay State/NIPSCO merger closed in late 1998, and it is therefore doubtful that the full benefit of any merger-related cost savings could be reflected in Northern's September 30, 1999 "test year." Likewise, since the NiSource/Columbia merger closed in late 2000, any "test year" with an end date prior to last quarter of 2001 is unlikely to show the full effects of the post-merger cost saving efforts at the parent levels of the organization.

Therefore, based on (1) the 1999 test year evidence presented in this case indicating that NU did not appear to be over-earning in that test period, and (2) the fact that the 1999 test year did not fully reflect merger savings from the NIPSCO merger, and that any recent historical test year prior to 2001 will not adequately reflect NiSource/Columbia merger savings flowing to NU, we conclude that the evidence presented in this case does not warrant further investigation and, therefore, deny the OPA's petition in this matter. However, a current look at NU's circumstances may provide support for the OPA's request. We recently directed Staff to analyze the benefits of initiating a rate investigation for Northern, to issue the question for comment (including any comments the OPA may wish to make), and present a recommendation for our consideration. See *Northern Utilities, Inc., Petition for Authority to Implement Therm Billing*, Docket No. 2001-398, Order (July 25, 2001.) We will continue to pursue the question of whether we should initiate an investigation of Northern's rates at this time or in the foreseeable future in Docket No. 2001-398.

Accordingly, we

## ORDER

That the Public Advocate's petition in this matter is denied, that a copy of this Order be mailed to interested parties and that this Docket be closed.

Dated at Augusta, Maine, this 1st day of August, 2001.

BY ORDER OF THE COMMISSION

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Dennis L. Keschl  
Administrative Director

COMMISSIONERS VOTING FOR:

Welch  
Nugent  
Diamond

## NOTICE OF RIGHTS TO REVIEW OR APPEAL

5 M.R.S.A. § 9061 requires the Public Utilities Commission to give each party to an adjudicatory proceeding written notice of the party's rights to review or appeal of its decision made at the conclusion of the adjudicatory proceeding. The methods of review or appeal of PUC decisions at the conclusion of an adjudicatory proceeding are as follows:

1. Reconsideration of the Commission's Order may be requested under Section 1004 of the Commission's Rules of Practice and Procedure (65-407 C.M.R.110) within 20 days of the date of the Order by filing a petition with the Commission stating the grounds upon which reconsideration is sought.
2. Appeal of a final decision of the Commission may be taken to the Law Court by filing, within 30 days of the date of the Order, a Notice of Appeal with the Administrative Director of the Commission, pursuant to 35-A M.R.S.A. § 1320(1)-(4) and the Maine Rules of Appellate Procedure.
3. Additional court review of constitutional issues or issues involving the justness or reasonableness of rates may be had by the filing of an appeal with the Law Court, pursuant to 35-A M.R.S.A. § 1320(5).

Note: The attachment of this Notice to a document does not indicate the Commission's view that the particular document may be subject to review or appeal. Similarly, the failure of the Commission to attach a copy of this Notice to a document does not indicate the Commission's view that the document is not subject to review or appeal.